UNCONDITIONAL CONSERVATISM AS A MEDIATION BETWEEN LEVERAGE AND SIZE TO FIRM VALUE

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Abstract

This research is motivated by the controversy regarding the benefits of conservative accounting numbers, intended to determine the direct effect of leverage and size on firm value, and the indirect influence of these variables through unconditional conservatism as an intervening variable on firm values in 2010 - 2017 on the Stock Exchange Indonesia. The results were that the variable unconditional conservatism can mediate the influence between size on firm value. There is a direct influence between leverage and size on firm value.

Keywords: Unconditional Conservatism, Firm Value, leverage, size

Introduction

Conservatism is a cautious reaction to the uncertainty that exists so that uncertainties and risks associated in a business situation can be adequately considered. The principle of accounting conservatism states that accountants must report the highest accounting information from several possible values of liabilities and expenses, as well as the lowest of several possible values of assets and companies (Lo, 2005). Prudence is a principle that recognizes costs and losses more quickly, recognizes income and profits more slowly, evaluates assets with the lowest value, and liabilities with the highest value. In addition, the application will produce income and asset numbers that tend to be low, cost figures that tend to be high, and the result, financial statements will produce profits that are too low (understatement).

Leverage occurs because the manager's policy in determining funding sources uses external sources, especially debt. Trade-off theory or balancing theory based on the assumption of easing Modigliani and Miller (1963). The theory states that if firm tax and bankruptcy costs are considered, the leverage relationship with firm value is non-linear. So at some point the use of debt will increase the value of the firm, namely the use of debt which provides benefits in the form of tax savings. But if at the point where the cost of bankruptcy exceeds the benefits of tax savings, then the use of debt will reduce the value of the firm.

Leverage describes the use of debt in the firm's operations. Research related to leverage has been carried out by Uchida (2006), in his research found that leverage (debt) has a positive and significant effect on firm value (Tobin's Q). In addition to the results of research by Jiraporn and Ning (2006), Faulkender et al. (2006), Amidu (2007), Li and Zhao (2007), using a measure of debt to asset ratio also shows that leverage has a positive effect on firm value. The same thing with the research conducted by Shahid (2003), Al-Malkawi (2007), Cheng and Tzeng (2011) using a debt to equity ratio.

Firm size is the size of the assets owned by the firm. Small firm will tend to use their own capital costs and short-term debt rather than long-term debt, because the costs are lower. While large companies are more likely to have strong funding sources. In this study, the measurement of firm size refers to being proxied by the value of the natural logarithm of total assets.

The size hypothesis is based on the assumption that large companies are more politically sensitive and have a greater burden of welfare transfers (political costs) than smaller companies. Large companies may have higher tax rates, but companies are also likely to gain greater political benefits (favorable agreements with government and import restrictions) as compensation for high tax rates. The larger the size of the firm, the higher the value of the firm. The increasing level of sales and total assets has an impact on increasing stock prices. With the increase in stock prices, the prosperity of shareholders will also increase. This level of sales and total assets is used as a signal for the firm to attract potential investors to invest their funds in it.

High leverage shows the amount of loan capital used to finance firm assets. The higher the results of this ratio, the greater the financial risk for creditors and shareholders. Leverage is said to be profitable if the firm can generate profits that exceed its fixed expenditure costs (constant interest on bonds and preferred stock dividends). Thus companies that have high debt will choose the application of conservative accounting. Leverage has a significant positive effect on accounting conservatism (Ahmed and Duellman, 2007). The results of Lo's (2005) study also state that the level of debt has a positive effect on the policy level of conservatism.

Research conducted by Lo (2005) and La Fond and Roychowdhury (2007) states that leverage has a positive effect on accounting conservatism. The higher the level of leverage, the greater the likelihood of conflicts that will arise between shareholders and bondholders, which in turn will influence conservative contractual demand for accounting (Ahmed and Duellman, 2007). This is supported by research conducted by Lo (2005) and LaFond and Roychowdhury (2007) stating that leverage has a positive effect on accounting conservatism.

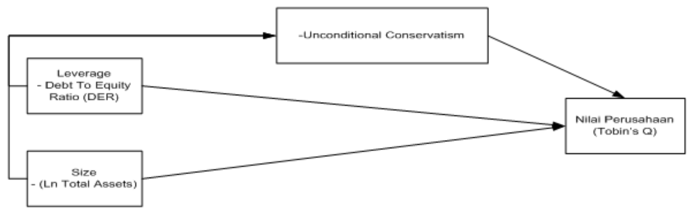
Lo (2005) states that firm size has a positive effect on the level of accounting conservatism, in line with the findings of Widya (2005) that firm size as a proxy for political costs has a positive influence on the selection of conservative accounting. The size hypothesis is based on the assumption that large companies are more politically sensitive and have a greater burden of welfare transfers (political costs) than smaller companies. Research conducted by Zmijewski and Hagerman (1981) supports size hypothesis, which states that large companies will choose accounting procedures that reduce reported earnings for the current period or the financial statements presented tend to be conservative. Large companies may have higher tax rates, but companies are also likely to gain greater political benefits (favorable agreements with government and import restrictions) as compensation for high tax rates. One of the things that can trigger managers to make profit declines (financial statements presented tend to be conservative) is the desire to minimize political risk (Scott, 2012).

Ahmed et.al (2002) and Zhang (2008) show that conservatism reduces the cost of debt, which makes external financing easier. Li (2010) found that conservatism increases cash flow from financing and increases future cash flows from operations. The various roles of conservatism such as risk reduction, availability of financing, efficiency of investment, and increase in cash provide a real channel of activity through conservatism that can prevent loss of firm value during a crisis.

LaFond and Watts (2008) prove that information asymmetry between inside and outside equity holders results in conservatism. Accounting conservatism reduces manager incentives and the ability to manipulate accounting numbers, reduce agency costs that may arise, and increase firm value and equity. Ahmed et al (2002) and Zhang (2008) show that conservatism reduces the cost of debt, which makes external financing easier. Li (2010) found that conservatism increases cash flow from financing and increases future cash flows from operations.

Based on the above description and previous research, the hypotheses in this study is:

H_1 : Leverage affects firm value
H_2 : Size affects the firm value
H_3 : Mediation Conservatism has an influence between leverage and firm value
H_4 : Mediation Conservatism has an influence between the size and firm value
H_5 : Conservatism has an influence on firm value



Source: developed for this study (2018)

Figure 1
Research Model

Methods

The population used in the study are companies listed on the Indonesia Stock Exchange in 2010-2017. The sample in this study were all companies listed on the Stock Exchange from 2010-2017, and had the data needed related to the measurement of the variables used for research during the period 2010-2017.

Result and Discussions

Data processing techniques using the SEM method based on Partial Least Square (PLS) require two stages to assess the Fit Model of a research model.

Table 1. *R-SquareTest*

	R Square	R Square Adjusted
Conservatism	0,329	0,309
Nilai Perusahaan	0,104	0,070

Source: *Output Smart PLS 3.0 M3 (2018)*

The results of the statistical output in the table above show that the adjusted R-Square value produced to explain the first model is the effect of exogenous variables (DER, Ln TA) on endogenous variables (Conservatism) of 0.309, which means that there is an influence of exogenous variables on endogenous variables. 30.9% and the remaining 69.1% is influenced by other variables outside the second model in this study.

Furthermore, the R-SquareAdjusted value to explain the second model is the effect of exogenous variables (DER, Ln TA and Conservatism) on endogenous variables (firm Value) of 0.070 which means the influence of exogenous variables on endogenous variables is 7% and the remaining 93% is influenced by other variables excluding the second model in this study.

Table 2. ***Path Coefficients (Mean, STDEV, T-Values)***

	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)	T Statistics (|O/STDEV|)	P Values
Conservatism -> NP	-0,318	-0,317	0,162	1,970	0,049
Lev -> Conservatism	-0,016	-0,021	0,066	0,251	0,802
Lev -> NP	-0,139	-0,140	0,035	3,954	0,000
Size -> Conservatism	-0,455	-0,457	0,072	6,338	0,000
Size -> NP	-0,282	-0,289	0,085	3,302	0,001

Sumber: *Output Smart PLS 3.0 M3 (2018)*

Table 3. ***Total Indirect Effects***

	NP
Conservatism	
Lev	0,005
NP	
Size	0,145

Source: *Output Smart PLS 3.0 M3 (2018)*

The Effect of Leverage on Firm Values

H_1 states that there is an influence between leverage and firm value. Based on the results of the PLS software analysis found the leverage variable has a negative and significant influence on the firm value variable. This can be seen from the coefficient value of -0.139 with a T-statistic value of 3.954 which is greater than the reference T-statistic value of 1.96. On this basis, the first hypothesis (H1) is accepted. The negative relationship of the leverage variable (DER) on the value of the firm shows that the higher the leverage (DER), the lower the value of the firm. This is because the use of debt will affect stock prices and firm value because the use of debt will cause the cost of ordinary equity to rise at the same level. With the higher debt used by companies to finance the firm's operations it will reduce firm value because with a high level of debt, the burden borne by the firm is also large. The results of this study support several research results relating to leverage variables that negatively affect the value of the firm as follows: Coles, et al (2004) provide results of leverage research has a negative and significant effect on stock price volatility or stock price volatility. The results of Coles's study, et al (2004) indicate that if leverage increases, then stock price volatility decreases which means that the firm's risk decreases. Villalonga & Amit (2004), in his research also found that leverage has a negative and significant effect on firm value (Tobin's q).

The Effect of Size on Firm Values

H_2 states there is an influence between size on firm value. Based on the results of PLS software analysis in table IV.9 found the variable size has an influence on the variable value of the firm. This can be seen from the coefficient value of -0.282 with the T-statistic value of 3.302 which is greater than the reference T-statistic value of 1.96. The results of this study indicate that it is assumed that large companies experience a tendency to attract attention and become a public spotlight, so that it will encourage the firm to implement better firm governance structures and mechanisms, thus the size of the firm has a positive effect on firm value. Firm size certainly will have a positive effect on the level of profitability achieved by the firm, as the results of research conducted by Hall and Weiss (1967).

The Effect of Unconditional Conservatism as an Mediation of Leverage on Firm Values

H_3 states that Conservatism can mediate the influence between leverage and firm value. Based on the results of PLS software analysis in the table found the conservatism variable can mediate the influence of leverage on firm value. It can be seen that leverage does not have an effect on conservatism with its T-statistic value of 0.251 which is smaller than the reference T-statistic value of 1.96. Furthermore, the conservatism variable has an influence on firm value with its T-statistic value of 1.970 which is greater than the reference T-statistic value which is 1.96. In addition, the PLS software and indirect effect are only 0.005. On this basis, the hypothesis (H3) is rejected. The results of this study support Sari and Adhariani research (2009) showing that the greater the leverage ratio used to measure debt convenants, the greater the likelihood that companies will use procedures that increase reported earnings for the current period or financial statements presented tend to be not conservative (optimistic).

The Effect of Unconditional Conservatism as a Mediation Between Size and Firm Value

H_4 states that Conservatism can mediate the influence between size and firm value. Based on the results of PLS software analysis in table IV.9, it is found that the conservatism variable can mediate the influence between size on firm value. It can be seen that size has an influence on conservatism with its T-statistic value of 6.338 which is greater than the reference T-statistic value of 1.96. Furthermore, the conservatism variable has an influence on the value of the firm with its T-statistic value of 1.970 which is greater than the reference T-statistic value which is 1.96. In addition, the PLS software and indirect effect are 0.145. On this basis, the hypothesis (H4) is accepted. The results of this study support the findings of Lo (2005) and Widya (2005), which states that one of the things that can trigger managers to decrease profits (financial statements presented tend to be conservative) is the desire to minimize political risk, meaning companies dealing with political costs , tend to make a profit reduction engineering with the aim of minimizing the political costs that they must bear. The results of this study are in accordance with the size hypothesis. A large size makes it easy for companies in funding problems. Companies generally have high flexibility and accessibility in funding problems through the capital market. This convenience can be captured as good information. Large size and growth can reflect the level of future profits.

The Effect of Unconditional Conservatism on Firm Values

H_5 states that there is an influence between unconditional conservatism on firm value. Based on the results of PLS software analysis in table V.9, it was found that the unconditional conservatism variable had an influence on the firm value variable. This can be seen from the coefficient value of -0.318 with the T-statistic value of 1.970 which is greater than the reference T-statistic value of 1.96. The results of this study indicate that most investors believe that the presentation of financial statements is more reliable, than they are opportunistic. The application of conservatism can be seen in PSAK (Statement of Financial Accounting Standards). The existence of PSAK in Indonesia raises the behavior of applying the principle of conservatism. Recognition of the conservatism principle in the PSAK is reflected by the existence of various choices of recording methods under the same conditions. This condition results in different figures in the financial statements which will eventually lead to conservative tendencies. The PSAK illustrates that there is an application of the principle of conservatism in Indonesia. Companies are advised to assess asset accounts on the balance sheet with a lower value, but when there is an obligation or burden management is required to immediately acknowledge the incident.

The method presented in the PSAK directly influences the figures presented in the financial statements. So that it can be said that indirectly the concept of conservatism will affect the results of the financial statements made. In addition, the application of this concept will also produce fluctuating profits which will reduce the profit predictive power to predict the firm's cash flow in the future.

This condition shows that companies in Indonesia consistently report conservative accounting figures, with the intention of giving signals to outside investors that the firm has reliable and high-quality information. This can also affect the value of the firm through its influence on financing, investment, and other real activities. These results support the research of Francis and Martin, 2010; Garcia Lara et al., 2010; Ahmed and Duellman, 2011.

Conclusions

The results of the study show that leverage affects the value of the firm, this indicates that the use of debt as a source of external funds can increase the value of the firm, as long as the present value of tax savings is greater than the cost of bankruptcy resulting from the use of debt. The firm's policy to use debt as a source of investment financing will increase the value of the firm if the use of debt is able to generate a profit greater than the interest cost of using the debt.

Size affects the value of the firm, this indicates that the greater the size of the firm, the tendency of investors to pay attention to the firm, because large companies tend to have more stable conditions and investors want to own the firm's shares, so as to increase the firm's stock price.

The results of conservatism show that the Unconditional Conservatism has an effect on firm value, this indicates that conservatism is carried out by management on a regular basis regardless of the condition of the firm, which routinely accelerates the recognition of expenses and routinely delays income recognition. So this conservatism will not cause profit to fluctuate, because it is routinely carried out by management.

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